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California Treasurer's Office Offers Warning Against Lottery Debt

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By [Rich Saskal](#)

SAN FRANCISCO The California treasurer's office is warning lawmakers that Gov. Arnold Schwarzenegger's proposal to raise money by bonding against the state lottery could make the state's already-challenging upcoming cash borrowing even trickier.

The governor's lottery bond proposal which would require voter approval in November and could potentially face court challenges might make investors uncomfortable with the short-term notes or warrants the state expects to issue by September, said deputy treasurer Paul Rosenstiel.

Rosenstiel delivered that message to lawmakers last week at a meeting of their budget conference committee and reiterated it Friday to The Bond Buyer.

"The lottery proposal raises a question of uncertainty," Rosenstiel said Friday.

The governor's lottery plan would generate \$5.1 billion to help balance the fiscal 2009 budget. His proposal would ask voters to implement the plan, specifying that a temporary sales tax increase would be used as a fallback if, for example, voters turn down the lottery proposal.

But what if the plan is approved but a legal challenge is filed that prevents lottery bonds from being issued at the end of fiscal 2009, Rosenstiel asked. In that scenario, the sales tax would not have kicked in.

"That could create a hole in the cash flows that we would expect to raise concerns from the credit markets," he said Friday.

Investors in short-term notes need to be confident that there will be cash available when the notes mature, he said.

Rosenstiel said the treasurer's office, the state controller's office, and the Department of Finance are working together to issue notes in whatever form is necessary.

The preference is for the treasurer to issue revenue anticipation notes, which will require a budget to be adopted probably by the beginning of August, which is by no means certain. If that is not feasible, the controller's office will issue revenue anticipation warrants, which do not require a budget. But they are more expensive.

The state last issued Raws in 2003, but market conditions have changed markedly since then, said Rosenstiel, who worked on that transaction as a banker for De La Rosa & Co., financial adviser on the

deal.

The 2003 Raws were sold with credit enhancement based on forward warrant purchase agreements in which seven investment banks committed to redeem the notes at maturity if the state could not.

Things have changed for big investment banks since then. "They are constrained," Rosenstiel said. "Some of them have suffered rating downgrades."

"We have to be very concerned about the capital markets and the ability of banks, investors, and the like to put up the \$10 billion," he said. "Wall Street is actually going to take a harder look at us this year, not just because we have difficulties, but because they have new standards and less capacity and will scrutinize us even more."

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